

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA WATER COMPANY (U 133-W), for an order authorizing it to increase rates for water service by \$19,826,100 or 29.72% in the year 2003; by \$6,327,800 or 7.31% in the year 2004; and by \$6,326,200 or 6.81% in the year 2005 in its Region III Service Area and increased rates for the General Office Allocation in all of its Customer Service Areas in this Application including: Arden-Cordova, Bay Point, Clearlake, Los Osos, Ojai, Santa Maria, Simi Valley and Metropolitan.

Application 02-11-007
(Filed November 4, 2002)

**ASSIGNED COMMISSIONER'S RULING
ADDRESSING THE CITY OF FOLSOM'S
PETITION FOR MODIFICATION OF DECISION 04-03-039**

Summary

This Assigned Commissioner Ruling sets a procedural schedule to address the City of Folsom's (Folsom's) petition for modification of Decision (D.) 04-03-039. An oral argument will be held on April 19, 2004. The impacts on Folsom related to the Commission's decision to void Southern California Water Company's (SCWC's) lease of water rights to Folsom will be considered separately from the impending application by SCWC for prospective approval of the lease.

Background

Decision (D.) 04-03-039 was issued on March 16, 2004. In that decision it was concluded that SCWC violated Pub.Util. Code Section 851 when it failed to gain Commission approval prior to effectuating a 1994 lease of 5,000 acre feet of water rights to the City of Folsom (Folsom). For that reason, the lease was voided from inception. The decision further states that, pursuant to the second paragraph of Section 851, Folsom's use of and payments for the leased water rights in the past are unaffected. However, the decision did not address Folsom's prospective rights for the water and ordered briefs to be filed on that subject.

On March 26, 2004, Folsom filed a petition for modification of D.04-03-039 requesting that the Commission clarify that with respect to Folsom, the Water Agreement between SCWC and Folsom is not invalidated on the ground that SCWC's action transferring the property was determined to be beyond its authority. Folsom also filed a motion to partially stay D.04-03-039, a motion to shorten time to respond to the petition for modification and the motion to stay, a declaration of Steven P. Rudolf in support of the petition for modification and a motion to have the petition for modification and motion to stay placed on the agenda for the April 1, 2004 Commission Meeting.

On March 26, 2004, a "Proposed Draft Decision of President Peevey and Commissioner Kennedy" (DD), which addressed Folsom's petition for modification was issued. Comments were due at 12:00 noon on March 30, 2004.

On March 26, 2004, an Alternate Draft Decision of Commissioner Lynch was also issued for comment. The voiding of the lease pursuant to Ordering Paragraph 7 of D.04-03-039 was stayed in order to clarify Folsom's continuing right to use water under the lease. The alternate draft decision was then adopted

at the April 1, 2004 Commission Meeting. There was no action taken on the Peevey and Kennedy DD.

Discussion

The Commission must act in an expeditious manner to address Folsom's petition for modification in order mitigate potential harm caused by the continuing uncertainty related to the future availability of 5,000 acre feet of annual water rights. Therefore, the issues raised in Folsom's petition for modification will be addressed now, separately from the Commission's consideration of SCWC's application for prospective approval of the lease as described in Ordering Paragraphs 8 and 9 of D.04-03-039. In its March 30, 2004 comments on the DD, SCWC indicated that it would shortly file such an application with the Commission, seeking Section 851 approval of the lease.

As described in the ruling below we will address Folsom's petition for modification on an accelerated schedule, which includes an oral argument. Folsom's request to partially stay D.04-03-039 and its motion for the shortening of time to respond to that request are moot considering the Commission's Order on the subject at the April 1, 2004 Commission Meeting.

Due to the very short comment period for the March 26, 2004 DD, additional comments will be taken. The DD is attached for parties' convenience. Parties may also address the DD at the scheduled oral argument.

Oral Argument

The oral argument will be held at 1:30 p.m. on April 19, 2004. The scope is limited to the issues raised in Folsom's petition for modification and the DD.

The agenda is as follows:

15 minutes	Introduction
20 minutes	City of Folsom
20 minutes	SCWC
20 minutes	ORA
15 minutes	Questions/Wrap-up

IT IS RULED that:

1. The motion of the City of Folsom to shorten the response time to its March 26, 2004 petition for modification is granted. Responses to the petition for modification, including the Declaration of Steven P. Rudolph in support of the petition for modification, shall be filed on or before April 14, 2004. If a party feels evidentiary hearings are necessary, it should so state in its comments, along with a specific description of what specific disputed material facts are in question.
2. Concurrent comments on the Proposed Draft Decision of President Peevey and Commissioner Kennedy, which addresses the City of Folsom's petition for modification, shall be filed on or before April 14, 2004.
3. Oral argument will be held in San Francisco, Hearing Room E, on April 19, 2004, at 1:30 p.m., to address the City of Folsom's March 26, 2004 petition for modification and the Proposed Draft Decision of President Peevey and Commissioner Kennedy.

Dated April 2, 2004, at San Francisco, California.

/s/ MICHAEL R. PEEVEY

Michael R. Peevey
Assigned Commissioner

ATTACHMENT

**PROPOSED DRAFT DECISION OF PRESIDENT PEEVEY AND
COMMISSIONER KENNEDY**

Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA WATER COMPANY (U 133-W), for an order authorizing it to increase rates for water service by \$19,826,100 or 29.72% in the year 2003; by \$6,327,800 or 7.31% in the year 2004; and by \$6,326,200 or 6.81% in the year 2005 in its Region III Service Area and to increase rates for the General Office Allocation in all of its Customer Service Areas in this Application including: Arden-Cordova, Bay Point, Clearlake, Los Osos, Ojai, Santa Maria, Simi Valley and Metropolitan.

Application 02-11-007
(Filed November 4, 2002)

OPINION GRANTING PETITION TO MODIFY D.04-03-039**I. Summary**

On March 16, 2004, the Commission adopted Decision (D.) 04-03-039, which grants Southern California Water Company (SCWC) authority to increase rates in its Region III Service Area. The Commission found that SCWC violated Public Utilities Code Section 851 (§ 851) when it failed to seek the Commission's approval for its lease of water rights to the City of Folsom (City). Additionally, the Commission granted only retrospective approval of the voided lease agreement. The City seeks relief, as it believes that serious and immediate effects have occurred because the Commission did not grant prospective approval of the lease. As such, the City has filed a petition to modify D. 04-03-039's treatment of

prospective water rights purchased from SCWC. After a review of the new information provided the City, the Commission grants prospective approval of the leased water rights to the City.

II. Background

By D.71889 issued January 24, 1967, the Commission authorized SCWC to transfer the City water system and 22,000 acre feet per year (AFY) to the City of Folsom. In November 1994 SCWC signed an agreement to lease approximately 5,000 AFY with the City. SCWC did not seek Commission approval under Public Utility Code Section 851 for the 1994 lease with the City. As a result, the Commission determined that SCWC violated § 851 by not seeking approval for a water rights lease agreement that it entered into with the City (D.04-03-039). Accordingly, the Commission fined SCWC \$180,000 for that violation. Moreover, the Commission determined that while the City acted in “good faith for value”, the City was entitled only to retrospective approval of the lease of water rights.

III. Discussion

This petition to modify narrowly focuses on the issue of prospective water rights purchased by the City in an agreement with the SCWC in 1994. The Commission found in D.04-03-039 that SCWC had violated § 851 by failing to seek Commission approval to lease 5,000 AFY to the City in perpetuity. The City alleges that by not granting prospective approval to the lease, the Commission has caused immediate and severe harm. Specifically, by placing a cloud over the City’s right to the leased water, the Commission has made it difficult or impossible for the City to refinance on unfavorable terms over \$100 million of existing utility bonds; has placed the City in potential default under existing bond indentures; jeopardized planned expansion in the City’s East Area particularly including the planned development of a desperately needed hospital

and urgent care facility; and generally rendered doubtful various developments contained in the City's master plan for the East Area all of which assume the continuing availability of the leased water.

To address these concerns we revisit the plain words of the relevant statute. The relevant part of § 851 reads:

...any disposition of property by a public utility shall be conclusively presumed to be of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser, lessee or encumbrancer dealing with such property in good faith for value...

D.04-03-039 (page 53) concludes that the City is a good faith purchaser for value and therefore entitled to protection of its water rights on a retrospective basis. The City argues that the Commission, by not also granting a prospective approval of the leased water rights, is misinterpreting the language and intent of the statute.

The Commission, however, must reconcile the City's needs with its obligation to enforce § 851 in order to determine whether the transaction (in this case, the agreement between the City and SCWC for leased water) serves the public interest. To this end, D.04-03-039 notes that there are several factors that the Commission must consider before granting § 851 approval. For example, the Commission must assess whether the proposed transaction will impair the utility's ability to provide service to the public. As such, SCWC must demonstrate that its water quality and supply problems can be addressed without the leased water supply (see Decision at page 44).

In D.04-03-039 it was concluded that SCWC violated § 851 when it failed to gain the Commission's approval prior to entering into an agreement with the

City for leased water rights. As part of the remedy outlined in D.04-03-039, the Commission voids the lease as to SCWC, and fines SCWC \$180,000.

In its petition to modify D.04-03-039, the City of Folsom has presented new evidence that heretofore has not been considered by the Commission. Ten years after the execution of the leased water rights agreement with SCWC, on March 16, 2004, the City first learned that the Commission had issued a decision voiding the leased water agreement. On March 26, 2004, the City filed a petition to modify D.04-03-039. Upon further review of the City's petition, we conclude that § 851 protects the City's acquired interest in the water both with respect to the past and to the future notwithstanding our voiding of the lease as to SCWC. Accordingly, within 30 days from the issuance of this opinion, we direct SCWC to file a § 851 application for the leased water rights agreement with the City. This requirement provides clarity to SCWC that it is expected to file a § 851 application.

In view of this revision to our original decision, we also revise our order. We direct that the parties limit their responses to a discussion of the following topics:

1. How SCWC will obtain water sufficient to serve its customer base without the 5,000 AFY leased to the City
2. The proper accounting treatment of future lease revenues under the City lease.

IV. Comments on the Proposed Draft Decision

The proposed draft decision of President Peevey and Commissioner Kennedy in this matter was served to the parties in this proceeding in accordance with Public Utilities Code Section 311(g)(1) and Rule 77.7 of the Rules and Practice and Procedure. Due to the unforeseen and emergency nature of the

issues addressed in this proposed decision, the comment period is shortened pursuant to Section 311(g)(2) and Rule 77.7(f). Interested parties are required to file comments by 12:00 noon on Tuesday, March 30, 2004.

Comments were timely filed by Southern California Water Company, City of Folsom and the Office of Ratepayer Advocates. The City of Folsom in its comments supports the draft decision with minor changes. Their comments have been considered and their recommended changes deemed not necessary. The SCWC supports the draft decision but seeks one clarification with respect to D.04-03-039's requirement that the water company file a brief addressing the rights of Folsom under three different circumstances. These comments have been considered and appropriate changes have been made to the decision to provide this clarification. None of the parties requested an evidentiary hearing.

In its comments, ORA challenges the draft decision's conclusion that Folsom is a "bona fide purchaser" and entered into the leased water rights agreement with SCWC in good faith for value. ORA argues that a common sense reading of § 851 would lead to a conclusion that the water rights in question: 1.) are useful to SCWC in its provision of utility service; and that 2.) prospective use of the leased water by Folsom cannot be granted until the Commission determines that the property is not useful to SCWC. Furthermore, ORA disagrees with the portion of D.04-03-039 validating the City of Folsom's use of SCWC's water rights on a retrospective basis, noting the underlying transaction is completely void under § 851. We disagree with the conclusions of ORA.

As noted in the Petition filed by Folsom, past Commission decisions, legislative intent, as well as Supreme Court decisions comport with the draft decision's treatment of Folsom's conclusive presumptive right to leased water from SCWC. ORA argues that the lease must be found void as to the past,

present, and future use of SCWC's water rights by Folsom (ORA Comments on the Draft Decision, footnote one, page 4). In ORA's view, the second paragraph of § 851 only entitles Folsom to seek recourse with SCWC. In effect, that determination would render § 851 meaningless.

In disagreeing with ORA's position, we take note of other relevant statutory guidance relating to Folsom's purchase of SCWC's water rights. The concept of a good faith purchaser for value comes from the law of sales. The law is extremely clear. The Uniform Commercial Code, for example, states: " A person with voidable title has power to transfer good title to a good faith purchaser for value." UCC 2403(1). In this case, the water company is the "person with voidable title" and Folsom obtained is the good faith purchaser for value. By virtue of being a good faith purchaser, Folsom obtained clear title to the water rights.

The Commission does not have the power under § 851 to declare Folsom's title to the water rights void; it has only the power to declare the sale of those rights void. The second paragraph of § 851, in our opinion, does little more than recognize that a good faith purchaser for value from an owner with good title, like the water company, is going to acquire good title from his seller. Even if we stretch the statute and say that it empowers the Commission to declare SCWC's title void, we are then back into the plain language of the Commercial Code: a seller with voidable title (SCWC before it sold the water rights to Folsom) conveys good title to a good faith purchaser.

Finally, it is worth re-emphasis to note that at the time of the transfer of SCWC's water rights they were neither used nor useful--indeed, that is why SCWC sold them. But ORA argues that because 10 years after the fact we declared the property useful, Folsom does not get the benefit of the statute's

conclusive presumption that property sold by the utility is not useful. This turns the law on its head.

This legal conclusion is manifestly unfair . By contrast, the draft decision preserves the Commission's regulatory obligation to enforce § 851 and applies a practical and equitable remedy that addresses the harm inflicted upon Folsom by D.04-03-039.

V. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and David Fukutome is the assigned ALJ in this proceeding.

Findings of Fact

1. In D.04-03-039, the Commission found that SCWC violated § 851 by not seeking the Commission's approval for its lease of water rights to the City.
2. As part of the remedy outlined in D.04-03-039, the Commission voided the lease as to SCWC, and fined SCWC \$180,000.
3. In D.04-03-039, the Commission granted only retrospective approval of the voided lease agreement.
4. As a result, the City has filed petition to modify D.04-03-039 because of the serious and immediate effects that occurred because the Commission did not grant prospective approval of the water rights lease.
5. The City may have to refinance on unfavorable terms over \$100 million of existing utility bonds.
6. The City may be in jeopardy in being able to finance planned expansions of the City's East Area.

Conclusions of Law

1. The City has demonstrated that there are severe and immediate impacts to its water supply and financial health because the Commission did not grant prospective approval of its leased water rights.

2. Pursuant to Government Code Section 11125.3 (a)(2), there exists a need to take immediate action in that the City of Folsom's water supply may be severely curtailed and its financial condition negatively impacted if the Commission does not review its D.04-03-039 adopted March 16, 2004; this need for action came to the Commission's attention subsequent to the mailing of its April 1, 2004 agenda.

3. The Commission in D.04-03-039 concludes that the City is a good faith purchaser for value in compliance with § 851.

4. In this instant case, the Commission must reconcile the City's needs for the leased water rights to its obligation to enforce § 851 by determining whether or not the agreement between the City and SCWC for leased water serves the public interest.

5. After a review of new information, the Commission concludes that § 851 protects the City's acquired interest in the water both with respect to the past and to the future notwithstanding the voiding of the lease as to SCWC.

O R D E R**IT IS ORDERED** that:

1. Within 30 days from the issuance of this opinion Southern California Water Company is to file a § 851 application for the leased water rights agreement with the City of Folsom.

2. We direct that the parties limit their responses to this application to a discussion of the following topics:

- a. How SCWC will obtain water sufficient to serve its customer base without the 5,000 AFY leased to the City.
- b. The proper accounting treatment of future lease revenues under the City lease.

Dated _____, at San Francisco, California.

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of the original attached Assigned Commissioner's Ruling Addressing the City of Folsom's Petition for Modification of Decision 04-03-039 on all parties of record in this proceeding or their attorneys of record.

Dated April 2, 2004, at San Francisco, California.

/s/ TERESITA C. GALLARDO

Teresita C. Gallardo

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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